

The Effect of Support Policies on Employment Growth through SMEs Support – Case of Republic of Kosovo

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Abstract

This paper examines the effect of support policies on employment growth through SMEs support. SMEs are promoters of economic development, but being small, they are also very vulnerable to the unfavorable business environment thus they need to be supported. The paper will specifically address the impact of government subsidies, loans, investment capital and interest rate on SMEs growth seeing from their turnover. Kosovo is a country in transition therefore it is expected that these effects will be interesting, as the opportunities of government institutions to help them are very poor either by the lack of means or by the wrong allocation of funds in sectors that have no influence in the economy. The analysis of the results was done using econometric models such as simple OLS regression GMM method. The result from these models have shown that SMEs in Kosovo have not been able to generate new jobs for the period of research, and government and credit policies need to be reoriented in order to help SMEs increase their employment. There are many studies that have provided different opinions about these effects. Hence, their findings and results from this empirical analysis will draw useful conclusions and recommendations.

Keywords: SMEs, turnover, effects, policies, subsidies, loans, capital investment, interest rate.

1. Introduction

Kosova is a small country and its economic processes are developing slowly. The main source of economic growth is production, which is used in small amount and insufficient. Consequently, the whole economy in Kosova is based on the private sector. The private sector in the country is characterized to a greater extent by commercial enterprises about 55%, then a considerable amount is taken by the construction and services.

These enterprises do not have much effect on the VAT, so they are not expected to have a major impact on economical development. On the other hand, these enterprises have a contribution in the circulation of funds because they not only increase the number of employees, but also the monthly income.

Given that the economic development in Kosova is largely dependent on the performance of the private sector, thus the government institutions in the country have been implementing various strategies for better functioning of this sector, notably by supporting entrepreneurial initiatives, by subsidizing investment projects and by capital investments which are assigned under national development priorities.

The banking sector plays a key role in the development of the private sector, as one of the main sources of finance for businesses. Even though, the loan interest in Kosovo is characterized as one of the most expensive, the banking sector on the other hand is considered to be the most stable in the region. Consequently, the private sector in Kosova is in a difficult position to contribute to economic development.

Another challenge for the institutions in Kosova remains the high level of informal economy, which is pulling out of circulation a large amount of potential funds for thorough, profitable and practical investments.

According to a report on the Government Program on the Prevention of Informal Economy in Kosovo for 2010-2012, the estimated amount of informal economy ranges from 39% to 50% of GDP¹. A "substantial contribution" for the growth of this phenomenon is considered the weak functioning of the judicial system, which is as a result of prominent failures by the international administration that led to the inability to build a functioning Judicial System as a key factor in the functioning of the democratic state.

2. SMEs structure in Kosova

The adoption of the Law No. 03 / L-031 in Kosova aims not only to amend and supplement the Law 02 / L-5 on SME Support, but to change the classification of enterprises according to the number of employees as well.

¹ GDP Development Strategy of 2012-2016 Government of Kosovo, www.mti-ks.org

Table 1. SMEs Structure of Kosova

Classification of enterprises	Number of employees
Microenterprise	1 to 9 employees
Small enterprise	10 to 49 employees
Mid-sized enterprise	50 to 249 employees
Large enterprise	Over 250 employees

Source: Kosova Business Registration Agency- ARBK

Private enterprises are lined up in three activities: trade, manufacturing and service. Considering the fact that we have a very low GDP, the manufacturing industry sector is less effective. The market in Kosova is more concentrated on the commercial companies and that means we only have the same money movement, so there is no money multiplication.

Generally speaking, the largest number of enterprises in Kosova are private, and this number has increased since 2000, namely about 86% of enterprises are privately owned, 10% households, 2% private / public sector enterprises and 1% any branch of foreign company / enterprise. Also, most enterprises are individually owned and fewer are other forms of business. The average number of business creation per day decreases gradually as a result of the technology perfection. Namely, for the registration of a company, the maximum days are 2.40, while the minimum is 1.65 days. Currently there are 36696 active enterprises in Kosova, 16 556 are commercial enterprises, 4677 manufacturing enterprises, 3621 accommodation and food service activities, 2628 are construction enterprises, and the rest are other types of businesses that are in a smaller number. These businesses are described by many difficulties in their activity, ranging from the lack of management experience, lack of financial means and access to loans. According to the international community, the business environment in Kosova is considered as unstable and with many obstacles in terms of business development opportunities. These barriers have caused foreign investors to be reluctant in investing their capital in a country with economic, political problems, lack of energy, etc.

3. Employment and Structure of Employees in Kosova

Due to the lack of a profitable production sector in Kosova, the country faces a high degree of unemployment. Specifically, in 2017 the unemployment rate turned out to be 30.2% in a number of 1198183 working-age citizens, while the workforce is 395740 people. This unemployment rate seems very high perceived from the statistical prism, but Kosova has the problem of massive informal employment.

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Referring to the number and type of active enterprises in Kosovo, their contribution to employment is concentrated in enterprises that deal with wholesale and retail trade. Specifically, there are 54609 employees in these enterprises, while 24457 employees are employed in the production, 16687 employees are employed in the construction, 27000 employees are in the service activities, and the rest are distributed in other forms of businesses. The table below describes the commitment and the status of the workforce in Kosova. The data are obtained from the Kosovo Agency of Statistics but have been adapted by the author through the available reports.

Table 2. Coverage of unemployment / employment in Kosovo

EMPLOYEES											
Category	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Workforce	52.3	46.8	46.2	48.1	-	-	36.88	40.54	41.6	37.6	41.3
Employed	29.0	26.5	24.3	26.4	-	-	69	70	66.66	51.9	71.3
Part-Time	23.3	16.8	17.8	16.3	-	-	11.1	11.9	8.3	7	6.3
Temporary	60.7	51.5	65.3	65.0	-	-	73	68.8	71.6	72	60
Self-employed	24.6	21.6	24.1	22.0	-	-	19.8	22.9	23.2	22.8	34.7
UNEMPLOYED											
Category	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
NO WORKFORCE(not active)	67.5	70.2	53.8	51.9	-	-	63.11	59.45	58.4	62.4	58.6
Unemployed	23.3	20.4	21.9	21.7	-	-	30.9	30	35.3	48	28.6
Unemployment among young people 15-24	75.5	70	73	73	-	-	55.2	55.9	60.99	57.6	47
Long-term unemployment	91.5	85	81.8	81.7	-	-	59.8	68.9	73.8	72.2	63.5
Unemployment Rate	44.9	43.6	47.5	45.4	-	-	28.1	26.9	35.3	32.9	28.7

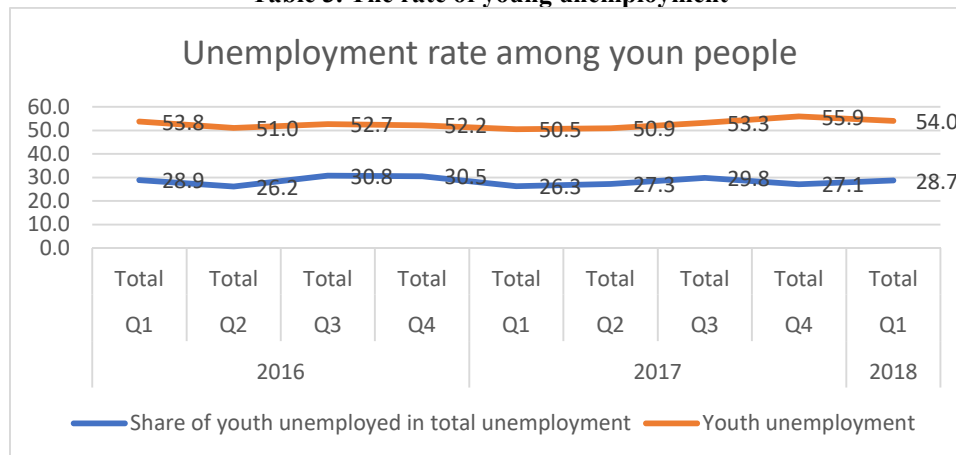
Source: Kosova Agency of Statistics, platform <http://askdata.rks-gov.net>

The major concern of unemployment in Kosovo is the high rate of unemployment among young people, which continues to grow. It is a paradox because these young people are over-qualified and do not fit into the jobs offered on the market. Small and medium-sized enterprises do not have a transparent job offer because they are

more family-oriented, many companies require low-skilled workers who often find no workforce, especially agricultural enterprises. On the other hand, the over-qualified labor market is overwhelmed in one hand, and with a lack of productivity on the other hand.

This represents a weakness in the organization of small and medium enterprises in Kosova, and a failure of the educational system to produce professional staff with the suitable skills and competencies. Therefore, the highest unemployment rate is also expressed among young people. This is a major concern for the future of Kosova, as these young people are ready to migrate to more developed countries. Below we present the unemployment rate among young people in Kosova.

Table 3. The rate of young unemployment



Source: The Kosovo Agency of Statistics, <http://askdata.rks-gov.net>

Despite the low employment rates, young people in Kosova are also more likely to work without employment contracts. During 2012-2016, almost half of the employed young people did not have employment contracts, whereas in 2016 this figure reached 54.8%

4. SME Support Policies

The Government of Kosova has developed various SME development strategies and policies to increase employment and reduce poverty. Some of the initiatives include: The Private Sector Development Strategy 2013-2017, the Employment Strategy 2010-2012, and then the SME Development Strategy for Kosovo 2012-2016 (with vision by 2020). In Kosovo, the SME Support Agency is responsible for implementing the SME development strategy. Often, the implementation of government-sponsored support programs and donor-funded SME are done by various Business Support Organizations, such as Business Centers, Business Incubators, Technology Transfer Centers, Innovation Centers, etc. Also, the government helps SME through subsidizing the making of manufacturing machinery, road infrastructure (capital investments), as well as organizing promotional events inside and outside the country, helping to create new businesses or creative ideas. It has also recently created the Ministry of Entrepreneurship and Innovation. Also, a Loan Guarantee Fund has been set up, which is expected to help ease the difficult access of these businesses with finances.

Loans are giving of funds or leasing of bank assets to finance business needs. But in Kosova, loans have been characterized so far by high costs and high criteria that have hampered SME access to finance. Therefore, it's still unclear whether the loans have been supportive or threatening. The interest rate is a deciding factor for borrowing. In Kosovo in 2017, the interest rate on loan has dropped to 6.99%, which is a hint that in future the loans will play the role of the supporter of the new business backing.

5. Research Methodology

It is of great interest to analyze whether these subsidiary policies have contributed to the growth of small and medium-sized enterprises. Thus, the collected data represent the following years 2006-2016. These data are provided by relevant institutions.

Two OLS and GMM econometric models have been used in this paper, where the data processing was done using the STATA statistical program. The first OLS model measures the effect of backup policies on the growth of the first SME in their circulation, while the GMM model was used to measure the impact of SME and the supportive employment growth policies.

The models will try to confirm the following Hypotheses:

- H1** Subsidies have a positive impact on the growth of SME
- H2** Capital investments have a positive impact on the growth of SME turnover
- H3** Loans positively affect the growth of SME turnover

- H4** The interest rate on SME loans negatively affects the growth of SME turnover
H5 SME have positively impacted on employment growth

5.1. OLS MODELS

OLS regression is one of the main techniques used to analyze data, and it forms the basis of many other techniques (for example ANOVA and generalized linear models). The effectiveness of the technique can be largely extended by the use of coding dummy variables² which include grouped explanatory variables and data transformation methods.³ This econometric model represents an abstraction of reality. In the simple regression model, we have the dependent variables and an explanatory variable including the random error that implies all other factors that may affect the dependent variables but are not considered in the model.

So dependent variables = Constant + explanatory variables + random error

On the left-hand side of the equalizer is the dependent variable whereas on the right-hand side of the equation appear as following:

$$Y_i = \beta_0 + \beta_1 X_1 + \mu_i$$

- a) Constant
- b) Explanatory variables and
- c) Case errors

In econometric models the influence of variables is evaluated through the P-value (probability value); The abbreviations used in the model are the following:

QI- SME turnover sub-subsidies

Cr- SME loan value

rI- SME interest rate on loans

CI- the value of capital investments

The STATA program has produced data on which we build the econometric model in numeric form. The data is for a 10-year period divided into each quarter. The econometric model takes the following:

$$\text{SME Turnover} = \beta_0 + \beta_1 \text{sub} + \beta_2 \text{Cr} + \beta_3 \text{rI} + \beta_4 \text{CI}$$

The results suggest that the model is important and it also explains the growth of SME by the dynamic supportive policies that are considered from the perspective of data combined in the model.

Table 4. The OLS Model findings

Variables	Dependent variable: SME turnover (QI)		
	OLS Model		
	Coefficient	Standard Deviation	P – value (significance)
Sub	.1755986	.0771223	0.031**
Cr	-.0419259	.0524306	0.431
Ri	-.3737244	.1848514	0.053*
CI	.2362083	.0448941	0.000***
Constant	22.66413	3.035998	
Observations	33		
R-squared	0.7308		

Source: Authors' Calculations,

The coefficients are significant and have a p - value lower than 0.05. The following data are given by the STATA software program. According to the data presented in the table, the first supporting policy used in this research, the subsidies, the result show that it has a positive and significant impact on the SME turnover. Such a result implies that with the increase of 1% of the subsidy variance, the turnover of SMEs will increase by 0.17 or 17% in the case of 100% growth of independent variable. Reasonably, subsidies are one of the most effective instruments to help the growth of SME in Kosovo, as they are irreversible tools, and that the funding is oriented towards the facilities and the machinery needed to carry out the enterprises activity.

This proves the first hypothesis that the subsidies have positively impacted the growth of SME turnover in Kosovo. On the other hand, the **logcr** index (loans) results to have a negative and unimportant impact on the growth of SME turnover. SME was also dictated by the loan timeline, because they cannot pay large amounts for loan installments, and as such they are likely to have long term rates and high credit rates. On the other hand, businesses need large amounts of funds, and for large sums of funds usually banks require additional criteria, such as: collaterals and/or mortgages⁴, as well as other requirements that make it more difficult for the small companies to

² The “dummy” variable is an artificial created to represent an attribute with two or more distinct categories/levels, Smita Skrivaneek, Principal Statistion, MoreSteam. Com LLC

³ Graeme Hutcheson, Ordinary Least-Squares Regression, In L. Moutinho and G. D. Hutcheson, The SAGE Dictionary of Quantitative Management Research. Pages 224-228. 2011

⁴ Financing Constraints of SMEs in Developing, Thorsten Beck, This draft: May 2007, pg. 5

achieve these standards.

The results suggest that the hypothesis is rejected (that loans have positively impacted the growth of SME turnover). The interest rate was found as very important factor for the growth of enterprises, which results in a negative and unimportant impact. The interest rate is a significant factor for the turnover of the enterprises, but of course its impact is negative in the trend of SME turnover. Specifically, for an interest rate increase unit, it influences – 0.37% on the SME turnover variables.

The results confirm the hypothesis that the interest rate has adversely affected the growth of SME turnover.

And finally, capital investments, as an independent variable, have a positive and singular impact on the growth of SME turnover. These investments in Kosovo are extending due to mismanagement and are requiring even greater costs than the cost of the project itself. However, for the period of study they have positively impacted the growth of SME turnover. These investments are not directly related to SMEs as activities but apply for the activities related to their operation such as deliveries and transportation of goods that have made SME more profitable.

This result confirms the hypothesis that capital investments have positively impacted the growth of SME turnover.

5.2. GMM MODEL

The Generic Moment Method (GMM) is a statistical method that combines the observed economic data with the information in the population momentum conditions to produce estimates of unknown parameters set in the economic model. The GMM model will show the impacts of SME turnover, loans, subsidies, interest rates and capital investments in employment growth. To produce reliable results unlike the OLS model, the data for the GMM model are expressed in monthly time series for the periods 2006-2016. The data source is listed above, and we are based on those data as reliable because they are official. The instruments in the model include:

(i) **The SME monthly turnover,**

(ii) **Subsidies,**

(iii) **Capital and investment,**

(iv) **Loans,**

(v) **Interest rate**

Using the software program, we managed to specify the **GMM instrumental variables** or **IV-GMM**, and we come to the following results:

Table 5. The IV GMM Model findings

Variables	Depended Variable: Number of Employees		
	IV GMM model		
	Coefficient	Standards Deviation	P – value (significance)
Interest Rate	-6.384808	.1859896	.0000***
Monthly Circulation	.0577396	.0692319	.404
Subsidies	.0030032	.0415869	.942
Capital Investments	.0376963	.0210624	.074*
Constant	27.42467	1.628267	
Observations	126		
R-squared	0.946		

Source: Authors' Calculations, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Some of the results are not foreseen in the hypothesis, however, the estimates are as follows:

(i) **Interest rate variable p-value 0,000** is significant but has a negative effect on increasing the number of employees;

(ii) **Monthly variable variance with p value 0.4** is not significant in the model and for reasons of not being significant the same is not interpreted.

Considering the results, there is no hypothesis that the SME turnover did not affect employment growth for the period under review.

(iii) **Variable** The subsidies in our empirical model are not significant and thus they do not explain the increase in the number of employees.

(iv) **Capital investment variable with p value 0.074** is significant and has a positive effect on increasing the number of employees, by referring to a one percent increase in capital investment, which will be associated with an increase of 0.037 percent in the growth in the number of employees.

6. Conclusion

Based on the results we can say that Kosova is encountering problems of SME financing strategies in relation to their needs and potential for development. Subsidies are not sustainable as they are provided for projects that have not afforded employment and this means that the allocation of funds is not done in sectors where there is a need and there is a greater possibility for value creation. So they help temporarily SMEs grow, but they are not able to

help it running it in a long term, or less chances to offer conditions to create new jobs.

On the other hand, considering their potential, loans appear to be unavailable for SME. The interest rate has a major negative impact on the growth of SME and this justifies the logic that loans remain a source of limited-access financing. Thus, SME are failing to make use of these resources for their needs, and this is due to the availability of loan criteria. However, with the decline in interest rates, we expect improvement in this regard, but always hoping that banks will not be surprising with their "defensive shares".

In conclusion, SME being in such circumstances show incapable to help employment in Kosovo. These enterprises in Kosovo are mostly family based and do not have transparent bids in the labor market. Grants were given for projects and ideas that did not have a concrete long-term plan, so they have failed to create new jobs. Another reason, the degree of informality in Kosovo is estimated to be 39%, and tends to go to 50% which excludes informal employment from the study. Involvement of informal employment would change the outcome, but the question is how long it will last, whereas for the enterprises it means additional costs. Anyway, this will be a topic of interest for other studies.

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